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UniCredit S.p.A. (UNCFF) Q1 2023 Earnings Call Transcript

May 07, 2023 3:59 PM ET | **UniCredit S.p.A. (UNCFF) Stock**, **UNCRY Stock** | UNCFF, UNCRY

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Start Time: 04:00 January 1, 0000 5:44 AM ET

UniCredit S.p.A. (OTCPK:UNCFF)
Q1 2023 Earnings Conference Call
May 03, 2023, 04:00 AM ET

Company Participants

Andrea Orcel - CEO
Stefano Porro - CFO
Magda Palczynska - Head, IR

Conference Call Participants

Ignacio Cerezo - UBS
Britta Schimdt - Autonomous Research
Benjie Creelan-Sandford - Jefferies
Andrea Filtri - Mediobanca
Azzurra Guelfi - Citi
Antonio Reale - Bank of America
Giovanni Razzoli - Deutsche Bank
Delphine Lee - JPMorgan
Hugo Cruz - KBW

Operator

Good morning, ladies and gentlemen. Before I hand over to Magda Palczynska, Head of Investor Relations, a reminder that today’s call is being recorded. Madam, you may begin.

Magda Palczynska

Good morning and welcome to UniCredit’s First Quarter 2023 Results Conference Call. Andrea Orcel, our CEO, will lead the call. Then, Stefano Porro, our CFO, will take you through the financials in more detail. Following Andrea’s closing remarks there will be a Q&A session. Please limit yourself to two questions.

With that, I will hand over to Andrea.

Andrea Orcel

Thank you, Magda, and thank you all for joining us today. The first quarter of this year has been a notable one for our industry. The economic shocks and unexpected fragility we have witnessed across the U.S. and in Switzerland raise question about both banks' strengths and how they're operating day to day. These were idiosyncratic and specific to a segment of our industry with limited read across to European banking. However, they do highlight the need beyond regulation for banks to be managed efficiently, effectively and responsibly, and continuing to strive for excellence, principles which are at the heart of UniCredit Unlocked.

While the recent approval of our €3.3 billion share buyback and 1.25 billion early redemption of AT1 evidence, UniCredit's specific strengths and resilience, the results I will present to you today further underscores UniCredit's transformation, a journey, which whilst accelerated is far from being over. Every day, we continue to unlock internal value, and today's results are just one of many additional milestones to come. We're winning and are well on our way to becoming the bank for Europe.

Let's start our presentation. We have delivered our ninth consecutive quarter of profitable growth and the best first quarter ever for the group. UniCredit Unlocked is releasing our banks potential and the management of our three levers is delivering financial success. We now move into phase two of our industrial transformation. We have outperformed our prudent macro assumption. Our alpha actions and strong lines of defense have further propelled our results and will position us to outperform in all environments in the future.

We are upgrading our 2023 guidance and setting a new floor for the future, underpinned by the actions we are proactively taking to prepare for an eventual, less supportive macro environment. We continue to build a sustainable competitive advantage, resilient and growing results and a robust balance sheet. All this amounts to an Unlocked UniCredit bank focused on continuously seeking to improve itself and create value.

This is the ninth consecutive quarter of profitable growth and the best first quarter ever delivering a 2.1 billion net profit, 20.4% RoTE at 13% and 3.4 billion organic capital generation. The supportive macro is further boosted by our industrial transformation, and our operating performance is protected by our lines of defense. We feel that these two levers are not often taken into consideration. We are investing and strengthening our bank for the future.

We're investing in the network through hires, upskilling through training and the rollout of the UniCredit University across the group and in our technology through exactly the same levers. We're extracting inefficiency from our complex organization, our complex processes, way of working, products and technology. This is about constantly transforming our bank into one fit for the future. Our results show that this is working with record performance across the board.

Net revenues are up 57% year-on-year. This is especially impactful given the targeting of profitable quality gross, so a gross that shows risk discipline and is EVA positive. Costs were reduced 1% and RWA 9%, in spite of growth, inflation and our investment in the future. The strengths of our operational and capital levers are shown, respectively, in a best-in-class 39.2% cost income ratio and 7.7% net revenue on RWA. These are also our best ever.

As a result, our return on tangible equity exceeded 20% at a 13% CET1, which is more comparable versus our peers as it extracts some of our excess capital. And we generated 111 basis points or 3.4 billion of capital organically reaching 16.1% in CTE1. The strategy we're implementing is uniting our bank as one franchise capable of delivering consistent quality, profitable growth over the long term.

As such, we are upgrading our net profit guidance too in excess of 6.5 billion for 2023. This is pre AT1 and cashes coupon of 400 million, but post 300 million of restructuring charges as we continue to strive for operating excellence. Accordingly, we're also upgrading our distribution guidance to equal or in excess of 5.75 billion.

Let's turn to the next slide. Our value proposition is simple. We are reengineering our bank into one with a sustainable competitive advantage. We are already well underway in the execution of UniCredit Unlocked and are now determined to go further. We have a clear vision to set a new benchmark for banking and be the bank for Europe. Our winning strategy is client-centric, focused on our strengths and continuously striving for excellence.

We have a four-pillar industrial plan, which reinforced our commercial machine and will now improve our operating machine. Our three financial levers will continue to deliver alpha-driven results and create value over the long term. So that is how we win the right way together. This value has already been within UniCredit, but we are able to release it now because we have established a common vision and are united by our distinctive culture. Our people are striving for excellence, and it is this which enable us to capitalize on our unique and irreplaceable model.

Next slide. Our strategic plan UniCredit Unlocked continues to leverage our inherent strengths and unlocking net value. We have 15 million clients across Europe and our unique gateway to the continent. We have 75,000 people in 13 leading local banks, 40% of which are in A or better rated geographies. We have two product factories and an evolving ecosystem of best-in-class partners, which enables us to deliver top quality solutions and products. We aim to grow by combining our world class factories and our local reach to provide products and services that competitor cannot replicate.

Our digital machine is resilient, and we have a strong data set. We're investing in both, to become a truly digital data-driven bank, positively impacting our clients and employees journeys. All of this is anchored by our shared ambition, principles and values. We strive for excellence and lead by example in ESG, always aiming to fulfill our purpose of empowering communities to progress.

We will now take a closer look to our industrial transformation plan in the next slide. Phase one of our industrial transformation plan is well advanced. This is about reinforcing our commercial machine. It has brought us closer to our clients and set the base for new run rate. Our people are unified. Our organization is empowered within a clear risk and capital framework. And we are integrating our frontline and product factories.

Phase two is just underway. This is about significantly improving the efficiency and effectiveness of our operating machine, which we are reengineering to further support our business. Our technology and product factories deliver scale and scope. We're simplifying our processes to increase speed and reduce cost.

We continue to broaden our product offering, automate and digitalize to enhance client experience. Our commercial machine now shows the right drive, the right mindset and an ability to deliver for clients. And we're just started. We now intend to support it with a more efficient operating machine. The combination of these two is what will create further value.

Next slide. We are already a different bank. Our transformation is well advanced, but we're far from being done. This slide highlights some of the many milestones we have already achieved with many more to come.

Let's turn to Slide 8. We aim to deliver differentiated financial results in any macro environment, thanks to our relentless focus on alpha. We're executing on all our three levers of cost, net revenue and capital. We continue to reduce non-business cost to invest while creating positive operational jaws where both revenues and cost contribute. We have grown revenue while maintaining structurally lower cost of risk. We're on course to achieve sustainable best-in-class RWA efficiency, all coming together to drive superior profitability [indiscernible] enabling outsize distribution.

As regards to beta, we were prepared for was one of moderate NII growth and high inflation. The scenario we currently face is one of improved rates and better GDP growth. We are boosting the supportive macro through our industrial transformation. We are protecting our operating performance with our lines of defense. We're therefore capable of differentiated results in all environments.

Next slide. Our results speak for themselves. Our gross revenues are up 18%, while our cost of risk has declined 93% to 8 basis points, thanks to the rationalization of our Russian provision, no longer needing to accrue overlays, and our strong asset quality and coverage which resulted in significant write backs. Our operating leverage is a key feature of these results and is now among best in class, as is our capital.

We note our 35% improvement in gross operating profit year-over-year. This confirms both the increasing strengths of our business and of our lines of defense, which as intended are currently propelling our profitability and organic capital generation. All of our business areas are contributing to this excellent performance.

We continue to create exceptional value for our shareholders. Our return on tangible equity at 13% CET1 reached 20.4%, increasing not only because of positive macro but also and more importantly, thanks to our ongoing industrial transformation and our lines of defense at work. Share buybacks continue to further enhance our value creation, especially given our low valuation. Note our tangible book value per share growth of 22% year-on-year. The 2022 share buyback currently in execution, combined with improved guidance, will further underpin these numbers going forward.

Let's turn to the next slide. Our product factories are growing organically and through partnership, strengthening the level of cooperation towards a full service client-centric bank. They are the engine of our capital-light revenue generation at 2.5 billion. We have begun to unlock the value of these factories, but there is more to come as we continue to invest in them.

Corporate solutions grew revenue 3% year-on-year, an excellent result given the strong Q1 of last year because of the market situation then. Client risk management, transactions and payments and more recently, advisory and capital markets continue to drive growth. This compensate for the rightsizing of specialized lending due to the TLTRO reimbursement and the removal of Euribor flooring.

We're investing organically in advisory to capture market recovery. We are rationalizing and further enhancing our payment solutions through partnerships. Individual solutions have been more negatively affected by the environment year-over-year, but they are now accelerating quarter-over-quarter. Protection continues to be a standout while life insurance, which in our case includes mostly unit linked and not [indiscernible], and funds and portfolio management are recovering. The expansion of our nonlife product offering beyond CPI is bearing fruit.

Italy; our Italian business had yet another outstanding quarter, demonstrating its ability to deliver sustained quality profitable gross. Net revenues were up 13% year-on-year, gross revenue 20%. This was driven by NII up 66%, thanks to strict management of the pass through, thanks to our strengths. While fees suffered year-on-year, they were up 8% quarter-on-quarter thanks to strong performance in protection and asset under management sales.

Costs were reduced 2%, thanks to our continued focus on simplification and streamlining whilst funding circa 200 new hires in the network. RWAs were reduced by 15%. As a result, we achieved our best ever leading operating and capital efficiency with a 36.1 cost income ratio and 9% net revenue over RWAs. Profit before tax in Italy was up 29% to 1.3 billion. RoAC exceeded 25% and the region contributed 50 basis points or 1.6 billion of capital organically to the group.

Our continued innovation in data was recognized by the Italian Banking Association as well as our innovation in products, for example, in home and health insurance. Finally, we continue to support communities by investing in our branches and restarting purchase of tax credit for Superbonus. ESG underpins all that we do reflected in our award for Best ESG Bank in Italy and in Europe 2023.

Germany; Germany's structural transformation continues powering excellent results. Net revenues were up 13% year-on-year, gross revenues were up 11. This was driven by NII up 8% and fees up 1% with an acceleration of a latter quarter-over-quarter. Costs were reduced nearly 6% while the ongoing transformation more than -- with the ongoing transformation more than compensating for inflation and investment.

We expect significant further efficiency through '23 and '24. RWAs were down 6% as well. Germany also reached its best ever operating and capital efficiency with a 40.4% cost income ratio and a 7.4% net revenue on RWA ratio. Profit before tax landed up 65%, up 700 million. RoAC reached 19.5%, more than twice its cost of equity.

The region delivered 30 basis points or 900 million of capital organically. We're supporting SMEs in their ESG transition by matching platform from green tech startups and have extended our smart banking model to micro businesses. We extended lending to medical services in underserviced regions to play our role in the community.

Central Europe; Central Europe has also set a new improved run rate. Net revenues were up 23% year-on-year, gross revenue 27%. This was driven by NII up 43%. Fees were stable quarter-over-quarter. Costs were also down 1% driven by our continued transformation in Austria. Our focus on operating and capital efficiency was reflected in a 39.8% cost income ratio for the region and 6.6% net revenue on RWA ratio.

Profit before tax was up 72% at 400 million. RoAC was 15.6% and the region delivered 9 basis points or 300 million of capital organically. Each bank is progressing its industrial transformation, while continuing to support clients' green and social transition. A significant progress in retail digitalization, Austria has enabled all startup products in mobile, while Czech Republic and Slovakia is now acquiring one-third of new clients remotely. We excel in our markets. UniCredit Hungary was awarded as the best international private bank in Hungary, while UniCredit Czech Republic was recognized as top acquirer in the Czech market.

Eastern Europe; Eastern Europe continues to deliver record profitable gross. Net revenues were up 39% year-over-year, gross revenue 32%. This was powered by both NII up 41% and fees up 6%. Cost gross was contained to 6%, less than half inflation and in spite of continued significant investments in digitalization and automation in the region. Our focus on operating and capital efficiency was reflected in a 34.6% cost income ratio and 9.3% net revenue on RWA ratio.

Profit before tax landed at 400 million. RoAC was 33.1%. And the region delivered 11 basis points or 300 million of capital organically. Our strong profitable growth is supported by each bank in the region. Croatia, Bulgaria, Bosnia reaffirm their market leadership position, introducing new products to help enhance the value of customer saving and improving overall quality of customer care.

Romania and Serbia further accelerated their retail growth and drove best practice solution in micro business, all in addition to their existing strengths in the corporate sector. Social impact banking initiatives have been rolled out across the region, as well as the first ever government bond issuance and numerous award.

Russia. We continue to take a clear and conservative approach to Russia, maintaining our support for Western companies while looking for opportunities to continue to derisk, minimizing current and future potential losses to the group. In the last year, we have decisively resized our operation, substantially reduced our exposure and increased our coverage of risk, both locally and cross border.

We have proactively enhanced our lines of defense and the impact from our extreme loss assessment has been reduced from 128 basis points to 38 basis points year-on-year, while group CET1 pro forma for an extreme loss impact has increased from 13.3% to 15.7%. We will continue in this direction.

Let's turn to the next slide. Our robust balance sheet is underpinned by broad-based increased strengths. We continue to see the visible outcomes of a conservative approach to capital, to asset quality, to liquidity and to interest rate risk. Our CET1 ratio has been driven by our high quality capital stock, transformed organic capital generation and sustainable distribution, all part of our long-term approach.

Our cost of risk is driven by a number of factors, including our high quality asset portfolio, low and higher quality NPEs, sound proactive staging, and superior coverage. In addition, we have substantially enhanced our overlays to best-in-class, enabling us to either protect or propel our operating results going forward and strengthen our risk discipline across the business. Finally, our liquidity buffers are strong. This is due to our high quality and diversified deposit base, our strong liquidity ratios, prudent asset and liability management, and finally our significant net positive exposure to ECB.

Next slide. We benefit from the highest CET1 with lowest dependence on AT1 which we continuously strengthened by best-in-class organic capital generation. This combined with distribution that works best-in-class continue to be set significantly below our organic capital generation results in an ever strengthening CET1. We do not believe many can claim that.

Next slide. Our solid credit portfolio means that our cost of risk is structurally lower than in the past. And we are prepared to meet future headwinds. Our gross NPE stock has declined to 12.6 billion with a much improved mix, three quarters being UTPs. Our net NPE stock is 6.5 billion. The bank is also surpassing peers when it comes to staging and coverage.

We continue to have the highest stock of overlays at circa 1.8 billion that will either protect or propel our result as they are released and they will be. Finally, we continue our discipline approach on new business with our expected loss of 26 basis points, 7 basis points lower than that on our stock, excluding Russia.

Next slide. Our robust liquidity profile allows us to better manage pass-through, balancing the interest of our clients with current and future profitability. Our deposit base is sticky, diversified, stable and high quality. Our liquidity ratios are all strong. We maintain a prudent approach to ALM, managing liquidity and interest rate risk separately. Excess liquidity is placed with ECB and this is well in excess of our residual TLTRO borrowings.

I will now handover to Stefano Porro, who will provide you with more detail on our excellent results of the first quarter. Stefano?

Stefano Porro

Thank you, Andrea, and good morning, everyone. Let's turn to Slide 22. Before I take you through the first quarter '23 results, please note that my comments are based on a year-on-year comparison, that is first quarter '23 versus first quarter '22, unless otherwise noted. Let's look at the P&L in more detail, starting with revenue. As a reminder, the majority of systemic charges are always booked in the first quarter.

This year, they amounted to 640 million, a decrease of 11% year-on-year, mainly driven by a lower single resolution fund contribution, partly offset by the tax on extra bank profits in Hungary, as flagged before, which was 49 million this quarter. In first quarter '23, we generated 5.9 billion of revenue, up 18% thanks to net interest up 1 billion. Excluding TLTRO, tiering and excess liquidity fee which no longer benefit from, revenue is up 23%.

Please note that trading no longer includes client hedging fees, which relate to the markup on client hedging transaction where the markup can be immediately locked. These are now reported under fees as they are characteristic aligned with other fee lines. Trading was ELF [ph] at 0.5 billion in first quarter '23, the lion's share of which is fixed income, currency and commodity business. This is 15% lower compared to a very strong first quarter of '22 that benefited from realized gains of the investment portfolio.

Let's turn to the next slide. Let me share some highlights of UniCredit's strong balance sheet and a robust liquidity position. Our favorable liquidity position starts with the structure of our balance sheet and a loan to deposit ratio well below 100% at a sound 90% where we're resilient and diversified the deposit base. More than 80% of our deposits are from retail and SME clients and are granular.

For retail, the average balance is below €20,000 and about 70% is guaranteed. Retail deposits are mostly sight, almost entirely so in Italy, while the term deposit share in Germany is higher at about 25%. Our deposit market share across the group is generally stable, while the decrease in volumes in the quarter mirrors our market trends and our focus on pricing. Thanks to our superior liquidity profile and balance sheet strength, we are in a position to be able to do so.

The pricing focus and single ticket large corporate use of excess cash explains the volume decline quarter-on-quarter. At the same time, retail deposits are only slightly down as some clients diversified their savings and shifted to assets under custody products, for example, BTPs in Italy. The clients are keeping their asset with us and our TFAs are up 7 billion in the quarter as a result of strong net assets under custody sales and the market performance.

Total deposits are still well above pre-2020 levels. We expect the overall deposit volume to continue slightly declining in 2023 as there is further rotation to asset under custody or asset under management, and as we prioritize pricing management and quality NII. This is also reflected in our deposit beta, which I will discuss in more detail later. We have about 220 billion liquid assets of which some 190 billion are regulatory HQLA.

The bonds in our investment portfolios are swapped to floating so we have virtually no interest rate duration risk. The large liquidity buffer translated to strong regulatory ratio. At first quarter '23, our liquidity coverage ratio was 163%, net stable funding ratio about 130%. The managerial target for LCR is at 125% to 150% range, and will also be met net of our TLTRO repayment in June.

We're in a comfortable position for our remaining funding plan this year. We have limited need for TLAC/MREL funding and no need to issue additional Tier 1 in the foreseeable future, thanks to our very high 633 basis points CET1 fully loaded MDA buffer, pro forma for the recently announced call of our 1.25 billion additional Tier 1.

Let's turn to Slide 24, and focus again on the quarter. Net interest income was 3.3 billion, up 10% quarter-on-quarter net of TLTRO, which no longer contributes to NII and was 0.4 billion in fourth quarter '22. We continue to experience a positive net interest dynamic driven by higher loan rates and still low deposit beta, net interest margin at 2%, up 11 basis points in first quarter '23.

Customer loan rates are up 66 basis points in the quarter across our region, leveraging on higher interest rates and thanks to our commercial action, which also led to front book margins being slightly higher than back book in the quarter. Average client loan volumes relevant for net interest are down 3.4 billion in the quarter, driven by Italy, mainly loans for ME and retail mortgages.

Client's appetite for lending as in general declined in the first quarter across Italy and Germany, while loan volumes are supported by 2.5 billion in USG lending in the quarter as we continue supporting our clients during transaction. Average client loans are stable year-on-year with focus on profitable clients, despite active portfolio management including the reduction of low performing businesses. Demand for loans is expected to be curtailed on the back of higher rates and we will concentrate on more profitable capital efficient loans.

The increase of customer deposit rate is limited to 21 basis points in the quarter, while the average Euribor three months was up 86 basis points. The IR customer deposit rate at 67 basis points is mainly driven by Germany and Central Europe, where our corporate business and IR term deposit composition play a prominent role. The rate also depends on the country.

In Italy, for example, where we have the higher stock of deposit, the customer deposit rate is 12 basis points, higher versus last quarter at 25 basis points. Our deposit pricing is below the system across most of our regions. Average commercial deposit decreased by 8 billion in Q1 '23, mainly in Germany, driven by the single ticket item I mentioned earlier, and it was also related to clients using part liquidity for corporate transactions. At the same time, deposits in Central Europe were stable and slightly grew in Eastern Europe. Average client deposit volumes are up 9 billion year-on-year.

Regarding the deposit dynamics this year, we expect stability for the less rate sensitive part of our client base, in particular retail and small businesses, while we are focusing on the deposit beta. Corporates will continue to be lumpy. We expect clients to keep investing or shifting the [indiscernible] excess liquidity to other assets. Let's take a closer look at our updated net interest outlook and sensitivity on the next slide, 25.

We've updated our managerial net interest income guidance, considering the latest deposit beta and rate assumptions. Based on a 3.5% ECB deposit facility rate by the end of Q2 '23 and the remaining stable thereafter, and the deposit beta around 40% at the end of the year, we expect and improve fully our 23 NII guidance of over 12.6 billion. This is mainly thanks to a better average deposit beta for the year at around 30%.

The observed deposit beta for the group for both sight and term deposit in Q1 '23 is about 22%. The deposit beta for retail and corporate clients is at around 11% and 37%, respectively. This slight increase by 2 percentage points in the quarter is mainly driven by Germany and Central Europe. While in Italy, we still have a low level of circa 10%. We continue to see a shift from sight to term deposit, in particular in Germany; however, sight for the group is still about 8% of our retail deposit and nearly 70% of our corporate deposit base.

We actively monitor the client behaviors and level of competition and we'll see how the upcoming TLTRO maturities impact the market. The net interest income sensitivity for a 1 percentage point of deposit beta is about 120 million at current rates and deposit volume assumptions. The net interest income impact from ECB deposit facility rate increase of 50 basis points is over 0.3 billion, which also depends on how client behavior and competitive dynamics develop. If the ECB starts reducing short-term rates, our deposit replicating portfolio which is factoring into our NII guidance will continue to support our net interest income.

Let's turn to Slide 26. Fees in Q1 '23 were 2 billion, down 2% year-on-year, mainly as lower asset under management impacted investment fees in Italy. Quarter-on-quarter, fees are up 11% thanks to an increase across all three categories with investment and financing fees in Italy and Germany particularly strong. We are well diversified and balanced, as you can see from the following year-on-year development of our different component parts of fees.

Investment fees were down 8%, as more than 8% reduced asset under management stock negatively impacted management fees and lower market levels combined with conservative client portfolio management led to lower asset under management upfront fees. This is partially mitigated by better assets under custody fees, thanks to certificate placement and some shift from deposit to asset under custody.

Investment fees quarter-on-quarter are up 13%, thanks to a recovery in assets under management upfront fees at 246 million in Q1 '23. Financing fees are down 4% due to higher securitization costs stemming from our active portfolio management strategy and lower credit protection insurance linked to retail mortgages in Italy. Financing fees are up 24% quarter-on-quarter, mainly driven by a recovering global capital market activity following a seasonally low Q4 and also loan fees in Germany.

Transactional fees were up 7%, thanks to payment and card fees driven by client activity across the regions and property and casualty insurance growth in Italy. Current account fees in Italy started to reprise reflected in new operating rates environment and are expected to negatively impact transactional fees worth about 20 million per month from April to around 2023. Client hedging fees were broadly stable as we continue to support our clients in defending their business outcome in this volatile environment.

Let's turn to Slide 27. As Andrea already took you through, costs fell 1% year-on-year. Let's take a closer look at HR and non-HR cost developments. HR costs down 2% year-on-year benefiting from lower FTE, down 4% as we keep focusing on the rationalization of non-business-related activities, while maintaining investment in key areas. The outcome of the negotiation within unions [ph] in Austria at about 8% increase for our population is considered in our full year '23 cost guidance. The trade union agreement in Italy is currently being renegotiated on a national level, while the German is valid until mid '24.

Non-HR costs are up 2% due to higher energy costs and the overall inflation impact. Net of the energy costs increase, non-HR costs are flat year-on-year. We will continue managing the impact of inflation effectively and structural cost improvements will help us keep our costs well managed beyond this year.

Let's turn to Slide 28. Cost of risk was at low 8 basis points in the quarter supported by our still low default rate at 0.8% and the good performance on repayment and back to bonus. Please remember that in Q1 '22, LLPs were almost completely related to Russia. And in Q4 '20, LLPs two overlays, we kept our overlay LLPs on performing loans stable in the quarter at around 1.8 billion to be used for any shop or to be released in the following two years.

Please remember, existing overlays are equivalent to over one year cost of risk of our only creditor log guidance. In Italy, the cost of risk of 29 basis points reflects ongoing sound asset quality and is mainly driven by provisioning on NPs. Cost of risk for Germany is low at 10 basis points and were the reduction in LPs. In Central Europe and Eastern Europe, we had negative cost of risk as a result of NP repayments leading to LLP releases.

Our updated spillover analysis confirmed the soundness of our group risk profile, which you can find in the annex. Also, in the annex, there are incremental details on our exposure to commercial real estate. The group commercial real estate portfolio towards clients operating in the construction real estate sectors is at 37 billion, with sound LTV of about 50%. Regardless of the industry in which the counterparty operates in, commercial real estate exposure financing and our corporate loans collateralized by commercial real estate is 60 billion.

In some Central and Eastern Europe countries, there is greater tendency to get real estate collateral on short-term working capital lines and other products amounting to about 8 billion which is included in increasing the commercial real estate exposure. Our exposure to commercial real estate versus total loan is in line or below market in Italy, Germany and Austria. The portfolio has been stable over recent years with declining gross NP ratio at around 4%.

We have a high portion of fixed rate component and limited refinancing risk, thanks to our maturity profile and large portion amortizing repayments versus bullet. The portfolio is high quality and diversified by region and type of property. The group's expected loss on new business at 26 basis points also confirms the credit quality of our portfolio origination and how this discipline is ingrained in our organization. We continue to be vigilant to our underwriting standards, which were already reviewed and refined and post the war breakout, reflecting the uncertain macro outlook.

Let's turn to Slide 29. Our underlying asset quality remains robust, gross NPEs at 12.6 billion reduced by over 5 billion year-on-year. NPE coverage is stable at 48%. NPE coverage does not include overlays on performing loans which come on top. Our strong asset quality, high level of provisioning for NPE and overlay LLPs, we are uniquely positioned to absorb macroeconomic impacts.

Let's turn to Slide 30. In Q1 '23, our risk weighted assets to date to 299 billion, down 10 billion quarter-on-quarter driven by continued active portfolio management measure worth 2 billion. We will focus on reducing low performing businesses and 5 billion of business dynamics, which includes about 3 billion lower market risks and the effect of lower loan levels. There were no meaningful regulatory impacts in the quarter and are not expected through end of 2024. Risk weighted assets are down 31 billion year-on-year and are expected to stay below 300 billion also by year end.

Let's turn to Slide 31. Andrea has highlighted our strong CET1 ratio at the end of the quarter at 16.05%, including the accrual of 0.7 billion cash dividend. In Q1 '23, we organically generated 111 basis point of capital, 67 basis points from the profit and 44 basis points for our proactive risk weighted asset management. We're at our plan. We have started to execute to the 2.34 billion first tranche buyback for 2022. As of 28th of April, UniCredit purchased shares equal to 2.6% of the share capital for a total consideration of some 940 million. We expect to commence the second share buyback tranche of circa 1 billion shortly after the completion of the first tranche. This is highly accretive for both DPS and EPS.

Let me please finish my part by highlighting some specific items for Q2 '23. As indicated by Andrea before, we expect about 300 million integration costs for 2023, a material part of which is envisioned to be booked in Q2 '23. At the end of April, the Hungarian government changed the methodology for the calculation of the 2020 free extra profit tax, which is expected to lead to about mid 20 million higher tax for this year, which will be accounted for Q2 '23.

And I will now hand back to Andrea. Please, Andrea, the floor is yours.

Andrea Orcel

Thank you, Stefano. I will now finish with some closing remarks. Turning to our group guidance for the full year and beyond. Given improved macro, accelerated progress on our industrial transformation and the effectiveness of our lines of defense, we meaningfully improved our guidance. As regard 2023, we now expect net revenue to exceed 20.3 billion, up from over 18.5 5 billion.

There is no change to our guidance on broadly flat fees on a rebased basis. They will be down slightly year-over-year due to a rising cost of securitization to support RWA efficiency and a one-off impact of the removal of current account fees in Italy, which is effectively compensated by a higher NII as we have already discussed.

I would like to bring again to your attention our expectation for cost of risk, between 30 and 35 basis points structurally lower than the past and with potential significant tailwinds that could drive it even lower. We expect our cost base to be less than 9.6 billion, down from less than 9.7 billion despite high inflation and continued investments, evidence of the ongoing benefit of our transformation.

We expect systemic charges of around 1 billion and restructuring charges of around 300 million to continue improving our efficiency in the foreseeable future. We expect stated net profit to be over 6.5 billion. We're referring to stated net profit to align with broader industry practice and for comparison purpose versus peers. It does exclude around 400 million in AT1 and cashes coupon, while it does include 300 million of restructuring charges that we expect to take mostly in the second quarter that will benefit us in the future.

The guidance does not include the potential positive impact from DTA write up. Our organic capital generation should be circa 250 basis points this year, up 100 basis points on previous guidance, supporting a 2023 distribution of at least 575 billion, an increase from our prior ambition of around 5.25 billion. Finally, we expect our return on tangible equity of 13% CET1 of circa 15%, an increase from 12.3% in 2022.

For 2024, we currently aim for net profit and distribution to remain broadly in line with 2023 guidance. This is based on a Euribor of 3% and an average pass-through at 42.5% with an exit rate of around 45%. We also assume there is a meaningful decrease in systemic charges by several €100 million.

Let's turn to Slide 34. Our unique investment case derives from the fact that the benefit from the current macro environment is amplified by our continued transformation and lines of defense, while they also further protect us from any reversal. As such, our current gross revenue, cost and capital numbers further benefit from our alpha generation while our gross operating profit is protected by our structurally improved cost of risk and the future release of overlays.

Finally, our outsize while sustainable distribution are supported not only by the continued improvement in profitability through the levers we have just described, but also are protected by our substantial excess capital that shall be deployed to underpin it when necessary. As such, the downside risk to both our profitability and distribution is significantly lowered by the levers I have just explained.

Let's turn to the last slide. We are crystallizing the net value from the macro environment particularly as it regards to the positive effect of rates, net of inflation and cost of risk. However, we also continue to be relentlessly focused on generating alpha, using phase two of UniCredit Unlocked to further propel current results. We aim to offset as much as possible of the expected reversal of the positive macro effect in the second half of 2024 and beyond to the benefit of our business and all our stakeholders.

As a management team, we see our job to be constantly and sustainably producing alpha and looking forward to the medium and long term to protect the bank from possible headwinds while benefiting to the fullest from possible opportunities. As such, we have accelerated and are now going further than UniCredit Unlocked with a further positive impact on fees, cost, capital efficiency and cost of risk.

We aim to ensure that the positive beta that is benefiting us today is replaced in as much as possible by additional alpha once it is reversed in the future. What we have shared today as we did with each one of the last eight quarters is evidence of what can be achieved with a common ambition, the right strategy and a distinctive culture and mindset positively obsessed with creating alpha sustainably.

Thank you. And I will now open for questions.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions]. The first question is from Ignacio Cerezo of UBS. Please go ahead.

Ignacio Cerezo

Yes. Hi. Good morning. Thank you for taking my questions. I've got two, if I may. The first one is on NII. You seem to be building deceleration basically into the rest of the year from the Q1 level. And considering calendar effects, et cetera, you would probably be expecting a little bit of a more stable revenue increase basically through the year. So I understand actually you have a quarter of your NII in CE. These days where probably rate expectations are a little more subdued into the next 12, 18 months, but if you can elaborate a little bit actually what is driving the slowdown through the year? And then the second one is on the cost side. Recurring question for me in the last two to three quarters, Stefano has alluded to that actually in the presentation, but just trying to understand if there is some degree of kind of hockey stick basically on the cost number beyond 2023, given those ongoing negotiations in Italy and the fact that you probably need to renegotiate trade union agreements again in Germany, mid '24 it was mentioned? Thank you.

Stefano Porro

So, Ignacio, in relation to net interest income, so as explained before, let's differentiate. So first, which is the level of pass through that we have, as alluded before in '22, is differentiated by country. So let's say is around 10% in Italy. To give the flavor in Germany is a little bit more than 30%. And in Central Europe is around 35%. So that is differentiated. The dynamic of the NII will be dependent on, one, the increased level of rates to the dynamic of the pass through. We are expecting, let's say, a good dynamic in Q2 as well. We might arrive to a peak, let's say, midyear clearly depending from the dynamic of the elements selected before, especially the pass through. In relation, you mentioned Central/Eastern Europe. In relation to Central/Eastern Europe, it is important to take into consideration also the dynamic of the average spread on the new lending, because the average spread on the new lending is positive, especially in Central Europe. So the front book pricing is better than the back book, by the way, not only in Central Europe, also in Eastern Europe. So this is also positively contributing to the dynamic of the net interest income. I leave the floor to Andrea for the cost.

Andrea Orcel

So on cost, no, you should not expect a hockey stick. So as we said already last quarter, while we face continued inflation and accelerate at high levels, and while we are not relenting on the investment that we believe we need to continue doing on the frontline and in technology, it is our job to offset as much of the inflation as possible. And I remind you that while we're guiding for below 9.6 billion at the moment, UniCredit Unlocked used to aim for 9.4 billion exit rate in 2024. And while I cannot tell you that we will be there, I can tell you that the management team ambition is to get as close to that number as possible. So our job is to continue to work on simplification, rationalization, streamlining, and bringing two common denominator of a scale of a group in the renegotiation of external contract and a number of our initiatives that are not very flamboyant, but are very effective to offset the inflation or repression on our cost base. And we think that getting excellence in operational efficiency is absolutely critical to maintain our performance and to protect '24 and '25 from the reverse winning rates.

Ignacio Cerezo

Thank you very much.

Operator

The next question is Britta Schimdt of Autonomous Research. Please go ahead.

Britta Schimdt

Yes. Hi, there. Thanks for taking my questions. On your cost of risk guidance, when you talk about the upside to 30 to 35 basis points, are there any specific regions that you have in mind? Clearly, CE and EE did a bit better or does it -- could it also include potential releases of overlay? So is it underlying or overlay? And if it's underlying, where? And then on the RWA development, can you give a little bit more color on the market and credit risk as well as the ongoing action that you've undertaken? What measures were included in this quarter? And what do you still expect in terms of proactive measures for the rest of the year? Thank you.

Andrea Orcel

Thank you, Britta. Let me start. So cost of risk. The first comment I would make is, if you look at our cost of risk across '22 and you extract Russia and overlays, we have been at single digits for now four quarters, actually five now. Okay. So the cost of risk at the moment is and remains very benign, and is very benign for us because we have a discipline origination and discipline cost of risk on new business that is offset by significant write backs, given our conservative provisioning and staging that we continue to have. If you do a simple average and you look at a cost of risk of 8 basis points in Q1 and you exclude the additional overlays and/or other things that I do not anticipate, you will find that it is very difficult for us to exceed 30 to 35, as we do an average for the rest of the year. Now this is just math. I don't know how the business will take that. But for the time being, this is the numbers. With respect to overlays, so at the moment, if I were to tell you where we see April, we see April exactly as we saw January, February, March in cost of risk. So we continue to have a benign environment. We continue to have write backs. We continue to see a benign environment. Will this change? It will absolutely change. But at the moment, it depends on when it will change and the significance of a change. As time progresses, obviously, the cost of risk of a year becomes more and more benign because the average moves in that direction. If the shock or when the shock arrives or when the worsening of cost of risk arrives, we have 1.8 billion to release to keep the cost of risk at our guidance or below our guidance. As we said in previous call, we cannot just keep the overlays going. We need to release them. So either we release them to absorb a shock and reduce any upward movement or eliminate any upward movement or release them because there is no reason to keep them, and therefore we will take the cost of risk down. So I think what we need to think in terms of cost of risk is that we are structurally lower than the past. At the moment, it is a benign environment where we benefit from write backs given our conservative provisioning. Going forward, there will be an increase. That increase will be offset by overlays. And if the increase is less than we anticipate, the cost of risk will be further reduced by overlays. With respect to RWAs, I would say the following. What we're doing on RWAs is progressive, methodical and recurrent. So the way we originate new business is very discipline, very focused and we need to originate business very simplified EVA positive. That means slower gross, but it means that all that we book flows to a profitable bottom line. If it flows to a profitable bottom line by definition, our net income generates or more than offsets the RWAs that are used to generate it. That is continuing and improving as the discipline flows through the entire system. Boosting that, we have our legacy book. Our legacy book, while very disciplined from a risk standpoint, was not very discipline from a capital allocation standpoint. As that book rolls or is reviewed or is renegotiated, we apply the same metrics. We are applying on new business to the back book. That is boosting the RWA reduction and is boosting our organic capital generation. We said at the beginning of UniCredit Unlocked not knowing well what UniCredit was capable of but we would generate 150 basis points per annum of organic capital generation that underpinned in excess of 60 billion of capital distribution. We have made 200 basis points in '21, almost 280 basis points in '22. And while we felt that it was difficult to keep the momentum, we are now confident we can do 250 basis points this year, and in excess of 150 going forward. That brings us to an organic capital generation that allows us to underpin prudently for our distribution while building capital. So that's the macro, but maybe Stefano wants to add a few points.

Stefano Porro

Yes. So on the cost of risk, Andrea already commented, maybe some data points. So the full data [ph] was mentioning 0.8 in the quarter for the group. So to give a sense is 0.3 in Germany, 0.5 in Central Europe, let's say around 1% in Italy. As alluded by Andrea, the dynamic in April is fundamentally in line with Q1. Important to consider that on the expected loss side, the new production in Italy is done at 36 basis points that is a lower expected loss than the stock and please remember 1.1 billion out of 1.8 billion of overlays are in Italy. With regards to risk weighted asset, 2 billion down in the quarter is active portfolio management action, primarily focused on EVA negative clients. So our specific initiative either not rollover, getting guarantee on repricing on active portfolio management client, vast majority of that 2 billion of credit risk is fundamentally loan dynamic that we are recommending before, better mix of the credit portfolio and a little bit of reduction of temporary different EVAs. Free below market risk is fundamentally reduction of the exposure and around 1 billion [indiscernible] from the FX hedge of the structural FX risk.

Operator

The next question is from Benjie Creelan-Sandford of Jefferies. Please go ahead.

Benjie Creelan-Sandford

Yes. Good morning. Thank you for taking the questions. First question was just again on the industrial transformation plan. You're talking about, again, improving the fee base going forward. You've mentioned the product factory delivering scale and scope. So just wondering, is there any further update or details on the product factory you are prioritizing? And is there anything on your appetite to potentially bring more factories in-house going forward? The second question was just a quick follow up. Just mechanically on the overlay provisions, just based on what you've said so far, all else equal, the macro, et cetera, plays out, as you expect. Do you expect to effectively be forced by the regulator or the auditor to release those provisions this year or is that something that could sort of flow into 2024 instead? Thank you.

Andrea Orcel

Thank you, Benjie. So industrial transformation and factories. So we continue to execute on the build-up of factories. So the plan is simple. What we want to have is world class factory, so to the level of quality that global banks have, but deliver for our client base, which usually is reached only by our more regional competitors. The combination of this two creates a competitive advantage, providing our clients with access to products and solutions that they would not otherwise have access to either because the regional competitor cannot scale the factory or because the global bank cannot reach them. We have been building that up either organically or through partnership and we continue on that trajectory. So you could say that advisory and capital market is an organic build. And to be very clear, we do not -- we are not planning to become a global investment bank. What we're planning to do is to offer our SMEs advisory and capital markets services that of the quality that they would not otherwise be able to benefit from. Client risk management, same thing on hedging of risk of FX, rates and commodities and that can continue. On the retail side, we are doing the same thing in asset management. So we went from maybe simplistically, but to make the point, a simple pass through between our providers in asset management and the client to creating more of a brain in asset allocation, in selection, in design of products to distribute through our network and therefore adding further value. That was phase one. Phase two has moved on identifying the part of the value chain. So the asset classes that we can produce internally while maintaining the quality of the product, that is the sense of onemarkets. That is the sense of Nova. That is the sense of [indiscernible]. It's that. And we are continuing, plotting around and going forward on the same direction. You take insurance, we have identified a partner. It's the best partner we can have. And we're integrating technologically. We are expecting the release of further product in protection from them. We are -- because of a partnership, offer training, we are offered a number of other benefits. And that is going through our network with an increased growth of protection that is growing at almost 20% year-on-year in spite of a reduction on CPI. And if I continue, I will repeat exactly the same thing for every partnership, meaning it's always a reinforcement of our capability, either internally, organically, or through partnership, but through partnership where we have a two-way relationship with our partner, and not a relationship of provider/ distributor. And this continues, and I don't think we're done, I think we have a couple of years more to continue at least. With respect to overlays, I would say the following. That has nothing to do with regulator. It has to do with accounting. We have taken overlays which are done above and beyond the conservative provisioning that we have on the portfolio. So while we look at the environment and we see an environment that is relatively benign, we are worried that it may degenerate and degenerate very quickly. For that reason, we have created overlays. And we identify very clearly what those overlays are linked to; energy costs, other things, there is a whole bunch of things that we identify. Within a reasonable period of time, which I would say is this year and next, either those events occur and therefore we are releasing overlays. And therefore, the increased cost of risk is reduced by the release of overlays, keeping our risk under control, or our cost of risk under control, or those events do not occur. And I'm still obliged to release them because there is no more any reason to keep them. What I think may have been missed is that this is not a new thing. If you look at 2020, '21, '22, we have released overlays every year. The point has been that because of the volatility and because of the uncertainty and because of the emerging of new risk, we have released them and rebuilt them. And therefore, you net-net saw no change in '21 and an increase in '22. But we have released the legacy overlays we had that we had built in 2020. This time, we don't think -- we don't expect new unexpected shock beyond the one we have in the overlays, so we don't expect that we will need to rebuild.

And that's why we're going to flow through the P&L over the next two years.

Stefano Porro

Benjie, maybe one point. The 1.8 billion are on top on the IFRS 9 macro LLP, so as correctly highlighted by Andrea are fundamentally connected to inflation and high energy costs and these are the two relevant drivers that we will look at in the next couple of years.

Benjie Creelan-Sandford

Okay. Thank you very much.

Operator

The next question is from Andrea Filtri of Mediobanca. Please go ahead.

Andrea Filtri

Yes, thank you. Very straightforward ones actually for me. The first is on the updated shareholder remuneration policy, if you're maintaining the same split between dividend and buyback? And the second is, what is the probability you attribute to the introduction of an Italian banking tax? Thank you.

Andrea Orcel

Okay. Thank you, Andrea. So the shareholder remuneration policy, as of now, we're keeping it unchanged, meaning 35% of net income is going to cash dividend, and the rest is going to share buybacks, as of now. I think we look at the value we generate with our share buyback. And therefore, depending where we go, we may change that percentage in favor of cash. Secondly, what I would say is, we realize that an increasing number of our investors expects a gently upward increasing of our cash dividends per share. And therefore, we look at the dividend yield. And we take all of these things in consideration to potentially make changes. We do recognize that once we change a percentage upward 35, 40 or whatever, it stays there as a minimum floor. You remember that when we had the shock from the invasion of Ukraine, we suspended the share buyback for prudency reason. We didn't touch the dividend. And we actually said that we would calculate the dividend on net income, excluding the shock for Russia. So we understand that the cash portion needs to be defended as much as we can reasonably. With respect to the probability of the government introduction of a banking tax in Italy, I think your guest is better than mine. I just know that it is unlikely to be part of the current introduction and that the discussion has been postponed. I don't think the probabilities are 100%. I think there is a discussion, and we'll see where that discussion takes us.

Operator

The next question is from Azzurra Guelfi of Citi. Please go ahead.

Azzurra Guelfi

Hi. Good morning. Two question from me, one on loans. So when I look at the development of the lending “among the different divisions,” Italy seems the one to have suffered more than the other. Can you give us some color on that? Is it modeling for the effort on the repricing? Is it customer driven? Any color on that will be great. And the other one is on a broader regulatory potential review in terms of liquidity ratio, or anything that could be reviewed in terms of guarantee of deposit. And if this is something that you are considering when you are assuming a decrease on the systemic charges in the coming years? Thank you.

Andrea Orcel

So maybe I'll start on the loans with a more macro dynamics of our lending. So I would call it the dynamic of our deployment of capital is driven solely by our focus on EVA positive deployment of capital. In Italy, you see a greater impact, because we feel that lending in certain segment, take mortgages as one, take large corporates as another is not recognizing the risk reward. And therefore, the profitability of a segment is not to the level that we think covers the cost of equity. I'm generalizing, it is not true everywhere. But as a result of that, we are showing a declining market share in mortgages and a declining market share in the corporate sector. And given that those two segments are large, a mortgage is larger than a consumer loan and a large corporate loan is larger than a small corporate loan, you're seeing a compression. We think that that dynamic is about to find a floor, because obviously as we have reassessed, we will not continue to lose forever, i.e. we're finding a place where we're happy with the client base and with the portfolio that we have, and the decline will stop. At that point, the gross in other segments like consumer lending or SMEs will be more visible. Now I'll pass it to Stefano.

Stefano Porro

Yes. You have also a question in relation to pricing that was partially mentioned before, so when we're looking to the pricing of the new production, so for example new near and long term [ph] production, declined rate on the front book is definitely higher than the back book. So what is expiring was either repaid. But also when you are looking to the client spread, so taking also into consideration let's say the funding costs, we are currently repricing, so around 20 basis points more, especially in Germany and in Central Europe, less so in Italy. So still when you're looking into the client spread in Italy, the new production is few basis points lower than the spread of the back book. But within that, the situation will normalize in Italy over time. With regards to systemic charges and the potential, let's say, implication in relation to the charges of single regional fund and deposit guarantee scheme. Before Andrea was highlighting the expectation for '24, the expectation for '24 is a reduction in relation to the single resolution fund component. Already this year, there was a reduction for next year. We are expecting a reduction of few 100 million. Considering the overall liquidity situation and liquidity framework of European banks, currently we are not expecting any change in relation for this approach. While for the deposit guarantee scheme standpoint, we are currently exploiting, let's say, a slight dynamic of the charges in '24 versus '23.

Operator

The next question is from Antonio Reale of Bank of America. Please go ahead.

Antonio Reale

Good morning, everyone. It's Antonio from Bank of America. Two questions for me please, the first one on capital and the second one on mitigating book NII. Starting with the first one, you've generated 100 basis points of organic capital this quarter, which is impressive. Your guiding for risk weighted assets to drop below 300 billion by year end. And of course, we know you gave guidance and distribution on earnings. So your capital is going to continue to move further away from the 12.5%, 13% target range you had. And admittedly, it's a lot more capital than you can consider distributed. So I wonder where does your strategic priorities stand here aside of distribution which is very clear? That's my first question. The second one, there's a lot of focus on banks hedging strategies. If you have a replicating book of 170 billion of roughly [indiscernible] with a relatively low back book yield, is there any of the investment contribution in your full year NII guidance? Or are you just focusing mostly on the commercial side? Can you share any more details on the contribution? What the back book yield looks like? And what could be the potential benefits going forward? Thank you.

Andrea Orcel

So I'll start with capital. So at the moment, we are clearly much more organic capital generative than we had expected. This allows us both to be a positive outlier in terms of our distribution and, and I underline the and, continue to increase capital. So not only we're not using our capital access to underpin our distribution, but we're also continuing to increase capital. Why are we doing that? And what is the plan? Well, number one, we're doing that because we're already an outlier in distribution and was just a point, but until it's fully appreciated, continuing to go further and further does not seem to have a lot of impact. The second thing is that we are in an uncertain environment. There is a lot of volatility. And while we see a positive base case, I continue to say that the only certain thing is uncertainty and we don't want to be found on the back foot. The third reason, and probably the most important one, is that for as long as our organic capital generation allows us to beat the sector on distributions, that's great. But we want a, let's say, recurrent sustainable level of distributions. And as I have said before, our excess capital can play a role anytime we get a shock or if our organic capital generation starts going down, which we do not anticipate this year and next, to underpin regeneration and keep the distribution at least at the same level that we have this year for the foreseeable future. So what we offer investors is for organic capital generation underpinned and through a gradual release of our excess capital, if and when it is necessary, a foreseeable future, lesser risk level of distribution at the level that we have today or higher. That's why we took floors. Not forever, but certainly for the foreseeable future. There is no other big plan about it. It is what it is at the moment. And that's where we take it. I will pass the replicating to --

Stefano Porro

So replicating portfolio, you're right. We have around 170 billion. The duration is around five years. Let's say that every year, we have a rollover of around 10%. And so every year, the front book rate that we can get is definitely higher than the back book. This is included in the guidance of over 12.6 billion in 2023. And that's the reason why I was also commenting before that even in case of short-term rates cut, for example, next year, we will have, however, a contribution of few hundred million of euro from the replicating version in '24.

Antonio Reale

Thank you.

Operator

The next question is from Giovanni Razzoli of Deutsche Bank. Please go ahead.

Giovanni Razzoli

Good morning. And thank you for your very detailed presentation. My first question is a more strategic field. I would say [indiscernible] proved more resilient than what you expected in the last couple of years, even the three major macro shocks that we had; so the comp [ph], the war and the energy inflation. And you likely saw -- already two years ago, you were [indiscernible] role with integral. I was wondering whether you think that medium term, it makes sense to allocate even more capital to the market also like significant sensitivity to rising rates, we have seen that Italy is one of the [indiscernible] describing accelerating the most and the deposit costs are more stable, either organically or via external growth? That's my first question. And my second question, if you can clarify sort of the evolution of the customer deposits in Q1, if I'm not mistaken at the country level, they were down. You mentioned that in Germany there was a one-off, if I'm not mistaken, if you can please clarify these? And whether at group level, there was a contribution from the [indiscernible]? Thank you.

Andrea Orcel

Thank you, Giovanni. So allocation of capital and more resilience, so I think the way we look at it is very simple. As we now have a granular assessment of the profitability of a deployment of our capital both by macro location through regions and more granular within every country. Every time that we see that we have an opportunity to deploy profitably above our cost of equity, which has increased, we do that. So there is -- given our overall capital position, we have absolutely no restriction in deploying the capital correctly in all of our geographies. The only restrictions are discipline on risk and discipline on returns. Beyond that, we're doing exactly what you're saying. But obviously, discipline on risk, discipline on return, and we will continue this way. And we find opportunity because others are retrenching, maintaining discipline on risk, discipline on returns, we will continue to do so. So you should anticipate that we try to do that. With respect to -- and obviously, as I said before, you do not see that because some of the growth that we're doing is obscured by the optimization of improvement of efficiency of our loan portfolio, as we get out of lending position that are unprofitable. And those mask some of the growth that we're already delivering. The second part on the deposits, and then I'll pass maybe more detail to Stefano, I think it's important that we look at deposit and liquidity in two ways. So if you are considered a flight to quality bank, you can benefit to that in two ways. One, you try to attract as many deposit as you can. Two, you try to improve your profitability as much as you can. And if you think about it, what is happening in the market is that depositors are giving a greater value to banks that are better capitalized, better covered, more liquid, less risky. So as it's normal, but we haven't seen that in many, many years, depositor will say, I'll take a slightly lower deposit base rate because this bank will give me the money back, simplifying okay. So given that our loan to deposit ratio is below 90%, we have no need to hover deposits. We look at them closely, but we have no need to press on increasing the deposits. But maximizing or the improvement or the maintenance of our pass through or rather maintaining our pass through as low as possible is critical. And why is it critical? Not only for current profitability, but because we will have a rate reversal, we will have a rate reversal. That rate reversal will occur sometimes in '24. We hope the second half, it could happen earlier. At that point, the pass through that will have been considered is the pass through that will exist. So you will have lesser rates, a higher pass through margin gets crushed. Effect number one. Effect number two, the costs that have not been defended and have increased are not going to go down just because inflation goes down. They're going to stay there. Revenue down, cost up, crush. Thirdly, the cost of risk will come at the tail end of a cycle as it always does. So revenue down, cost up, cost of risk up, crush. So what we're focusing on relentlessly is to avoid that and making our profitability sustainable in '24, '25 and beyond. How are we doing that? Defend the pass through in as much as possible. So the NII crushes less, develop further the fees through the transformation of our factory, keep the cost down, and if possible, lower. So when the revenues go down, our costs are not found to be higher, and keeping all of our provision and buffers so that when cost of risk goes up, we have buffers to offset it. In this way, we should be able to maintain a much greater degree of the profitability we have found for the first time in 15 years in the foreseeable future. And all of this is connected in such fashion.

Stefano Porro

So I'll give you some data points. So it's important to distinguish end of period versus the average. So end of period Q1 versus Q4, deposits are down 12 billion. 7 billion is Germany, 6 billion is Italy. 10 billion out of 12 billion is corporate, mainly large corporate. So as commented more than once for pricing reason and for some transaction done by these corporates. When we are looking on the other end on the average deposits, so average Q1 versus average Q4, I think it's a better metric to avoid some volatility. The deposits are down 8 billion, but in this case is 6 billion for Germany. Same reason, large corporate. And Italy is down by just 1 billion.

Giovanni Razzoli

Okay. Thank you very much.

Operator

The next question is from Delphine Lee of JPMorgan. Please go ahead.

Delphine Lee

Yes. Good morning. Thanks for taking my questions. I just wanted to go back to NII and I just heard your comments. Just in terms of the outlook for '24, given that -- because data you're assuming 42.5%, and based on the sensitivity 1 percentage increasing, the probability is quite high. So it sounds like we're going to get a 1.5 billion potential headwind from the probability to increase. Just wondering on the other moving parts, do you expect anything to offset that? I know you mentioned a couple of 100 million for application portfolio, but just wondering if it is possible to maintain NII flat next year or even increasing? And then my second question is regarding capital and other big dynamics. You talked a little bit about how you're optimizing the legacy portfolio which is not capital efficient. Is it possible to get a bit of -- just a flavor of the size of that legacy book just to understand how much are there mitigation we can get in coming years? Thank you.

Andrea Orcel

So, thank you, Delphine. First of all, let me be clear that the impact on our NII is an industry thing. It is not specific to UniCredit. If anything, we think we are a little bit more asymmetrical on the way down, meaning we are going to suffer a little bit less on the way down. Why do we think that? Number one, because as we're demonstrating, we're capable of managing the pass through because of our strengths and liquidity position a lot better than average. And that will help us when rates reverse. So if we are at that level of pass through, then we expect the industry to be on average higher, or we will be below that level of pass through. So that's the first thing. The second thing that underpins our NII symmetrically is the replicating portfolio, because we have replicated less in the past and we can now benefit for replicating more in the future, or rolling further in the future. And the new loans are obviously stripping at better rates. So these things will reduce the shock. The other thing that will reduce the shock is, as I said before, a lesser drag from the continued optimization of our portfolio by pulling back from segments that we think are EVA disruptive that will not continue forever. And when you stop that, the benefit from what we're doing in consumer finance and we're doing on SME loan and in other places will come much more clearly visible. In any case, our expectation at the moment is that we see NII peeking between second and third quarter. And we see, because of the conjunction of rates in Europe getting to their maximum level and pass through being higher, but not as high as the exit rate of a year. From there, it will follow a trend in our opinion where rates will be held at that level for a certain period of time, and then will decrease while pass through will start converging. The speed of those two things is very unclear and depends on the strength of the economy and on the dynamics of inflation. So we can have a scenario -- the scenario is in the presentation, but it can change. With respect to how we are offsetting, because what you're saying is correct. If all of that happens, banks will have a very significant reversal of the NII tailwinds quite soon, relatively soon, is continue to working on the factories to boost our fees. So part of the boosting fees will occur physiologically, because when rates drop, our asset management fees are going to improve. Part is due to better integration in protection, new products in protection, what we're doing in payments, et cetera, et cetera, that should be giving some tailwinds from I would say the second part of '24 onwards to our fees. The other thing that we're doing is obviously driving costs down and keeping our cost of risk as low a level and keeping buffer to protect it going into '24 and '25. So I do think that for us, the real challenge or the real ambition is not so much what we're going to generate and make in 2023. In a certain way, while we're doing well, the dies are cast. What is the challenge and the ambition is to be able to protect as much as this newfound profitability on a sustainable basis in '24 and '25. And that's what we have been doing through the transformation and the lines of defense starting the summer of last year. And we will continue to do.

Stefano Porro

Yes, you had a question in relation to which is, let's say, the part of the portfolio that we can still focusing on for risk weighted asset efficiency measures. So let's break down into our portfolio. So if you look at our risk weighted asset and their related credit risk, around 70 billion are the retail portfolio, 180 billion is the corporate portfolio. The main focusing on the corporate portfolio, so on the 180 billion, let's say, that you have 10% of that that you can optimize is around €18 billion. It's clear that not everything done via reduction, because we can also work on that portfolio via repricing working with the clients and so on. So this is more or less a portion of that can be also securitized and so on. So in your eyes between '23 and '24, that is the portion of the portfolio that we'll be looking at.

Delphine Lee

Thank you very much.

Operator

The next question is from Hugo Cruz of KBW. Please go ahead.

Hugo Cruz

Hi. Thank you. I just have a question around the tradeoff between buybacks and M&A. Have you discussed that with the regulator? And do you think that if you have a large deal where the performance CET1 ratio of UniCredit doesn't change, do you think the regulator might still raise issues with a buyback execution risk? Thank you.

Andrea Orcel

Sorry, Hugo. I missed or we missed the first part of your question. The tradeoff between -- can you repeat, please?

Hugo Cruz

Sorry, between M&A and buybacks, if you have discussed that with the regulator?

Andrea Orcel

I don't think we have a debate with regulators on tradeoff between buyback and M&A. I think the tradeoff between buyback and M&A is based on value. And I think you can mathematically look at it this way. Let's suppose just hypothetically, you have a cash acquisition, you're buying earnings, you're buying a certain capital position, you're buying a certain liquidity, you're buying that and you're integrating the group with the same share count. Alternatively, you have the same earnings of UniCredit with a lower share count. At that point, which one is your better investment? That's as simple as that. If you cut off all the strategy of a noisy [ph] industrial, which one is the better investment? I would argue, but if you look at the progression of our results, which we obviously believe in, buying our shares has been the better investment, heads on shoulders [ph] and continues to be. If that were to change adjusted for execution risk, et cetera, we may act differently. As far as the regulators are concerned, I will not answer, but the significance of our distribution is looked at considering both our profitability, our organic capital generation, our starting and ending level of CET1, and they're all in our favors. And I guess any M&A that hypothetically we were to look at will be looked at on the impact on the bank, and its risk and capital base. I don't think we're looking at it in any different way from them, but I don't want to answer for them.

Hugo Cruz

Thank you.

Andrea Orcel

Thank you very much, Hugo.

Operator

Mr. Orcel, this was the last question. Back to you for any closing remarks you may have.

Andrea Orcel

Thank you, everyone, for following our results call and we'll see you at the next quarter. Thank you very much.

Operator

Ladies and gentlemen, thank you for joining. The conference is now over. You may disconnect your telephones. Thank you.

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